

Arbour Energy Inc.
Management Discussion and Analysis
December 31, 2004

Overview

The following Management Discussion and Analysis (“MD&A”) of the financial results of Arbour Energy Inc. should be read in conjunction with the accompanying audited financial statements and related notes for the year ended December 31, 2004. The calculation of barrels of oil equivalent (“boe”) is based on a relative energy content conversion ratio of six thousand cubic feet (“mcf”) of natural gas to one barrel of oil.

Additional information related to the Company is available for view on SEDAR at www.sedar.com, or by requesting further information from the Company’s head office in Calgary.

Description of Business

Arbour Energy Inc. was incorporated under the Business Corporations Act (Alberta) on April 9, 2001 to carry on exploration and development of crude oil and natural gas reserves.

Operations and Capital Expenditures

As a qualifying transaction, Arbour participated in an exploratory well in the Lochend area of Alberta. This well is currently shut in and will be re-evaluated to determine if further work can be done to establish production.

In 2003, Arbour acquired a 22.5% working interest in an oil and gas well in the Pembina area which currently produces approximately \$ 3,000 per month of revenue to the Company.

During 2003, Arbour experienced significant losses and filed for protection under the Bankruptcy act. As part of the proceedings, the Company filed a proposal to its creditors in which creditors would receive the first \$1,500 of their debt and approximately half of the balance of their debts on a pro rata basis. The Company’s proposal was accepted resulting in a gain on settlement of debt for the Company of \$457,260. Settlement of the debt was funded through \$215,000 held in trust as at December 31, 2003 with the remainder repaid from a private placement of 6,000,000 common shares at \$.05 per share for gross proceeds of \$300,000. During June 2004, the Company was removed from bankruptcy protection and resumed normal operations.

On May 31, 2004, the Company entered into a preliminary agreement with Crazy Hill Resources Ltd. to acquire a producing oil and gas property near Drayton

Valley, Alberta comprised of six wells producing oil of 44 BOPD and gas of 60 MCFD. The agreed purchase price was \$1,000,000 consisting of \$350,000 cash and 650,000 common shares at \$1.00 per share. Closing took place on November 1, 2004.

In May, the Company also purchased a 45% working interest in a Farmout Agreement in the Meekwap area in Alberta for one oil well. The purchase price consisted of \$67,500 in cash and 157,500 common shares. After further testing, Arbour has elected not to tie in the well.

The Company has participated in drilling a shallow gas development well in the Kirkpatrick Lake area of Alberta. The capital cost was \$55,000 for a 50% interest and is capable of producing 60 MCFD. Tie in is occurring in May of 2005. Arbour also purchased a 50% interest in 3 additional wells in the same area for \$175,000 cash and 150,000 shares in the company. The net production of one producing well is 60 MCFD.

In August, the Company entered into a \$10,000,000 loan agreement with Merendon Mining Corporation Ltd., a private company incorporated in Alberta. Arbour has an option to purchase 5% of the issued and outstanding shares of Tarsands Recovery Ltd., an entity engaged in development of technology to enhance oil recovery from the Western Canadian Tar Sands, in exchange for the principal balance of the loan plus accrued interest, if any, as well as the issuance of 5,000,000 common shares of the Company.

In November, Arbour purchased a 50% interest in 2 sections of developable land in the Bow Island area in Alberta. Drilling is anticipated to begin sometime in the last quarter of 2005.

Subsequent to year end the Company entered into a Participation Agreement for a 45% working interest in the Sedalia area of Alberta. Drilling is to commence in May of 2005.

Also subsequent to the year end, Arbour announced that it has acquired all of the issued shares of Canadian Oilsands Recovery Enterprises Ltd. ("COREL") for \$5,300,000 plus 5,000,000 common shares. COREL holds the master operating license relating to oilsands recovery technology and intends to build a commercial plant in the summer of 2005. As at the year end, the Company had made a \$300,000 deposit towards the acquisition.

The Company has also established a US subsidiary, Arbour Energy US, Inc. subsequent to the year end. It has merged with Biltmore Enterprises Inc., a Nevada Corporation. Biltmore Enterprises Inc. changed its name to Arbour Energy U.S., Inc. The company is listed over the counter in the United States.

During the year, the company has raised \$13,480,715 through the issuance of 9,985,715 preferred shares and continues to raise equity financing subsequent to year end.

Selected Annual Information

The following information is derived from the financial statements of the Company for each of the three years ended December 31, 2004, 2003 and 2002.

	2004	2003	2002
Total Revenues and Interest Income	\$ 243,453	72,467	15,143
Net loss per share, basic and fully diluted	\$ (0.074)	(0.294)	(0.021)
Total Assets	\$ 16,669,465	363,107	2,185,045
Long Term Liabilities	\$ 13,075,522	58,560	228,080
Cash dividends declared	-	-	-
Number of shares outstanding	13,983,237	4,862,502	1,333,333

Results of Operations

The Company incurred a loss for the year of \$301,236 (2003 – \$1,432,891). As the Company acquired new producing properties during the year, annual production revenue increased from \$72,467 in 2003 to \$243,453 in 2004. Correspondingly, production expenses increased from \$23,957 in 2003 to \$94,796 in 2004. Interest revenue also increased from \$6,040 in 2003 to \$77,863 due to a \$10,000,000 loan agreement entered into during the year. General and administrative increased significantly from \$190,525 in 2003 to \$468,392 in 2004. As the Company was active in acquiring producing properties during the year as well as in raising capital, general and administrative costs increased in turn. With the issuance of preferred shares during 2004 with a 5.75% cumulative rate attached, \$98,389 of interest has been accrued. As the preferred shares are convertible into common shares, they are being accreted such that the liability at maturity will equal the gross proceeds. Accretion of \$18,364 has been included in interest on preferred shares. The current period includes \$ 25,107 for stock-based compensation, compared to \$16,281 in the comparative period. During 2003, a write-down of a non-producing property of \$1,866,183 and a ceiling test write-down of a producing property of \$14,196 resulted in significant depletion and depreciation of \$1,975,782. As there were no write-downs during 2004, depletion and depreciation leveled off to \$127,196. Adoption of the new recommendations for Asset Retirement Obligations resulted in a change in accounting policy for the previous year provision for future removal

and site restoration costs of \$61,481. The new accretion of asset retirement obligations for 2004 was \$2,000. Interest and bank charges decreased from \$2,153 in 2003 to \$184 in 2004. During 2004, the Company also experienced a foreign exchange loss of \$10,261 with none for the comparative period. A gain on settlement of debt pursuant to the proposal to the Company's creditors under the Bankruptcy Act during 2003 was \$475,260 with no gain for 2004.

As the Company elected to early adopt the new recommendation of the CICA for stock-based compensation, both 2003 and 2004 were calculated by the Black-Scholes option pricing model. This is a non-cash transaction which is credited to contributed surplus, and no effect on cash flows of the Company.

On February 16, 2004, Rick Dawson resigned as a director. On June 11, 2004, Cliff Monar, Michael Gardner and Gary Strashok resigned as directors and Dennis Morice and Heinz Weis were appointed directors. On the same day, Dennis Morice was appointed President and Secretary. On September 9, 2004, Dean Strashok resigned as director. Also, on September 9, 2004, Michael Gardner resigned as Chief Financial Officer and Vice-President, Finance, Gary Holden resigned as Chairman of the Board of Directors and Dean Strashok resigned as Corporate Secretary. On the same day, Dennis Morice was appointed Chief Executive Officer and Chief Financial Officer of the Company. Arthur Wigmore was also appointed a director on September 9, 2004.

On July 6, 2004, the Company delisted its common shares from the TSX Venture Exchange and was listed on the CNQ Exchange.

Liquidity and Capital Resources

In 2004, Arbour raised \$2,150,074 net of expenses from public placements. In exchange, the Company issued 2,150,735 common shares. Of the \$2,150,074 raised, \$107,317 was received subsequent to year end. The company also converted a short-term note from a shareholder in the amount of \$300,000 in exchange for 6,000,000 common shares.

The Company also raised \$13,480,715 from the placement of 9,985,715 redeemable preferred shares. Of the total raised, \$1,834,609 was received subsequent to year end. In addition, \$39,285 was received as a share subscription deposit. The preferred shares are convertible to common shares but have been recorded at the fair value without the conversion feature. The difference between the principal amount of \$13,480,715 and the fair value of \$12,577,197 is \$903,518 and has been recorded in contributed surplus as the fair value of the conversion feature of the preferred shares.

The Company had a healthy working capital at year end of \$4,619,514 as compared to a working capital deficit last year of \$166,907. The positive working capital is a result of the placements of common and preferred shares.

Off-Balance Sheet Arrangements

As of December 31, 2004, the Company has no off-balance sheet arrangements.

Business Risks

Competitive Conditions

Arbour is a member of the petroleum industry, which is highly competitive on all levels. The Company competes with other companies for all of its business inputs, including exploration and development prospects, access to commodity markets, experienced technical personnel and available capital.

The Company strives to be competitive by maintaining a strong financial condition and by utilizing current technologies to enhance exploration, development and operational activities. The Company recognizes that it is a small player in the industry and, as such, seeks profitable joint venture relationships in order to access the technical and industry expertise of other companies.

Arbour competes with others in this area, bidding for mineral rights at Crown land sales and acquiring producing properties and working interests in projects already partly owned. To mitigate the effects of competition, Arbour generally tries to obtain operatorship and to own as large a working interest as possible in its producing properties to control the access to, and timing of, its field operations, particularly drilling.

Environmental Considerations

The Company is pro-active in its approach to environment concerns. Procedures are in place to ensure that the utmost care is taken in the day to day management of its oil and gas properties. All government regulations and procedures are followed. The Company believes in well abandonment and site restoration in a timely manner to ensure minimal damage to the environment and lower overall costs to the Company.

The Company's estimated asset retirement obligations are provided using the Canadian Institute of Chartered Accountants' new recommendations. Under the new recommendations, an asset retirement obligation is recognized at fair value when incurred, and a concurrent asset retirement cost is capitalized to the related asset and amortized to income over its estimated useful life. At December 31, 2004, the Company had \$260,643 of asset retirement obligations.

Risk Factors

Dividends

The Company has paid no dividends on its shares since incorporation.

Commodity Prices

The Company's revenues, future rate of growth, results of operations, financial condition and ability to borrow funds or obtain additional capital, as well as the carrying value of its properties, are substantially dependent upon prevailing prices of oil and natural gas. Historically, the markets for oil and natural gas have been volatile, and such markets are likely to continue to be volatile in the future. Prices for oil and natural gas are subject to wide fluctuation in response to relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty and a variety of additional factors that are beyond the control of the Company. These factors include the level of consumer product demand, weather conditions, domestic and foreign governmental regulations, the price and availability of alternative fuels, political conditions in the Middle East, the foreign supply of oil and natural gas, the price of foreign imports and overall economic conditions. It is impossible to predict future oil and natural gas price movements with certainty. Declines in oil and natural gas prices may materially adversely affect the Company's financial condition, liquidity, ability to finance planned capital expenditures and results of operations.

Resource Exploration and Development

Drilling with respect to the oil and gas properties in which the Company has an interest are at an exploratory stage and involve the drilling of test wells which may not be successful or economic. Resource exploration and development is a speculative business and involves a high degree of risk, which even a combination of experience, knowledge and careful evaluation may not be able to avoid. There is no assurance that even if commercial quantities of oil and gas are discovered, that an oil and gas property will be brought into commercial production.

The discovery of oil and gas reserves is dependent upon a number of factors not the least of which is the technical skill of the exploration personnel involved. The commercial viability of oil and gas reserves, once discovered, is also dependent upon a number of factors which may be beyond the control of the Company, including marketability and price, proximity to infrastructure, government regulations and environmental protection requirements.

While not the operator of exploration programs on its resource properties, the Company does participate in operations that are subject to the risks normally incidental to the operation and development of resource properties, including the drilling of such properties. In respect of oil and natural gas well, unexpected formations or pressures, blow-outs and fires could be encountered, all of which could result in personal injuries, loss of life and damage to property for which the

Company may be ascribed some responsibility. In accordance with customary industry practice, the Company may not be able to or may elect not to insure against all such risks.

Certain oil and gas properties in which the Company has an interest may be difficult to access during break-up or inclement weather, which are risks normally encountered by most industry participants.

Title Matters

The Company has investigated its rights to participate in the exploration and development of its various resource properties and to, the best of its knowledge, those rights are in good standing. No assurance, however, can be given that applicable governments will not revoke, or significantly alter the conditions of, the applicable underlying grants and authorizations and that such grants and authorizations will not be challenged or impugned by third parties.

Competition

The oil and gas industry is intensely competitive and the Company must compete in all aspects of its business with a substantial number of other companies which have greater technical or financial resources. As a result, the Company may be unable to acquire rights to exploit additional resource properties on terms it considers acceptable. Accordingly, there can be no assurance that the Company will acquire any interest in additional properties that would yield reserves or result in commercial operations.

Environmental and Other Regulatory Requirements

All phases of the Company's operations are subject to environmental regulation in the various jurisdictions in which it operates. Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations. Environmental hazards may exist on the properties in which the Company holds interests which are unknown to the Company at present which have been caused by previous or existing owners or operators of the properties.

Government approvals and permits are currently, and may in the future be, required in connection with the operations in which the Company participates. To the extent such approvals are required and not obtained, exploration and development of the properties may be curtailed or prohibited from proceeding.

Failure to comply with applicable laws, regulations and permitting requirements may result in enforcement actions thereunder, including order issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. Parties engaged in operations on resource properties may be required to compensate those suffering loss or damage by reason of the activities thereon and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations.

Conflicts of Interest

The directors of the Company are engaged and will continue to be engaged in the search for resource property interests on their own behalf and on behalf of other companies, situations may arise where the directors and officers may be in direct competition with the Company. Conflicts of interest, if any, which arise will be subject to and governed by the procedures described in the *Business Corporation Act (Alberta)* which require a director or officer of a company to disclose any interest in transactions involving the Company and, in the case of directors, to refrain from voting on any matter in respect of such interested transactions unless otherwise permitted under such Act.

Forward Look Statement

This discussion and analysis contains forward-looking information. Actual future results may differ materially from that contemplated herein.